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Introduction to IFRS – US GAAP Differences

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Agenda

Introduction & background

First Time Adoption of IFRS

Differences in Principle

Difference due to Choices

Difference due to level of detail

Areas not addressed by IFRS

What guidance exists under IFRS?

Standards	IAS 1....41	IFRS 1...8
Interpretations	SIC	IFRIC

The Good, the Bad, and the Ugly

- The good
  - You know more about IFRS than you think
  - Many areas are similar to US GAAP
- The bad
  - There are significant areas of difference
  - New way of thinking about standards
- Just plain ugly
  - There has been historically lax practices in applying IFRS ("IFRS lite")

IFRS Hierarchy

- In absence of a Standard or Interpretation that specifically applies to a transactions management should use its judgment and consider the applicability of the following sources in descending order
  - IASB Standards and Interpretations
  - IASB Framework
  - Other standard setting bodies with similar conceptual framework (e.g. U.S. GAAP)

A “Principle-Based” Approach

- No longer simply understanding the “rules”
- Will need to focus more on…
  - The “substance” of transactions
  - Evaluate whether the accounting presentation reflects the “economic reality”
- Renewed focus on use of professional judgment
- Comparability versus uniformity

Perspectives on Practice

- Different practices exist in the application of IFRS
- Regulatory and interpretive approaches need to be converged
  - Accounting should conform with the "spirit of the standard"
- Challenge for regulators, companies and auditors is making sure that consistency exists within the conceptual parameters of the standard
  - Having transparent disclosure also is key

Areas "Substantially" Converged

IFRS	Topic
IAS 1	Presentation
IAS 2	Inventories
IAS 7	Cash flows
IAS 8	Errors
IAS 20	Government grant
IAS 21	Foreign currency
IAS 23	Borrowing costs
IAS 28	Equity accounting
IAS 31	Joint ventures
IAS 33	EPS

Areas "Substantially" Converged, cont.

IFRS	Topic
IFRS 2	Share based payments
IFRS 3	Business combinations
IFRS 4	Insurance contracts
IFRS 5	Discontinuing operations
IFRS 6	Extractive industries
IFRS 7	Financial instruments - disclosure
IFRS 8	Segments

Areas Not Converged

IFRS	Topic	Convergence Project
IAS 27	Consolidation Policy	Joint
IAS 29	Hyperinflation	None
IAS 36	Impairment	Joint
IAS 37	Provisions	Joint
IAS 38	Intangible assets	FASB
IAS 40	Investment property	FASB
IAS 41	Agriculture	None
IFRS 1	First-time adoption	None

Areas Where Some Convergence

IFRS	Topic	Convergence Project
IAS 10	Post balance sheet	FASB
IAS 11	Construction contracts	Joint
IAS 12	Income taxes	Joint
IAS 16	Property	None
IAS 17	Leases	Joint
IAS 18	Revenue	Joint

Areas Where Some Convergence, cont.

IFRS	Topic	Convergence Project
IAS 19	Employee benefits	Joint
IAS 32	FI – presentation	Joint
IAS 34	Interim reporting	Joint
IAS 39	FI – recognition/measurmt	Joint

Terminology – All in a Word

International	US
Shares	Stock
Stock	Inventory
Reserves	Equity allocation
Associate	Equity investee
Provision	Accrued liability
Scheme	Plan
True and fair	Present fairly

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First Time adoption of IFRS

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First time adoption – IFRS 1

	IFRS	US GAAP
Standards	IFRS 1 provides detailed guidelines for first-time adoption of IFRS	No specific standard
General principles	Full retrospective application of IFRS in force at time of adoption, unless specific exceptions and exemptions in IFRS 1 permit or require otherwise	Generally full retrospective application unless transitional provisions in a specific standard require otherwise

Overview of IFRS 1

- Applicable when an entity makes its first explicit and unreserved reference to IFRS
- Generally apply retrospectively all IFRS effective at reporting date
- Only requires one year of comparative financial information
- Must explain effect of transition to IFRS

Terms To Remember

- **First IFRS financial statements**
  - First annual financial statements which contain an "explicit and unreserved" reference to compliance with IFRS
- **Date of transition to IFRS**
  - The beginning of the earliest period for which an entity presents full comparative information under IFRS in its first IFRS financial statements
- **Reporting date**
  - The end of the latest period covered by annual financial statements or by an interim financial report

Key Dates

Apply IFRS standards effective on December 31, 2010 retrospectively

Calculate values of balance sheet on January 1, 2009 (not presented)

Optional Exemptions

Optional exemption	Choice
Business combinations	For all business combinations accounted for under previous GAAP: • Do not restate business combinations before the date of transition; • Restate all business combinations before the date of transition; or • Restate a particular business combination, in which case all subsequent business combinations must be restated

Optional Exemptions (cont.)

Optional exemption	Choice
Fair value or revaluation as deemed cost	For PP&E, certain intangibles and certain investment property: • Use cost in accordance with IFRS; • Use fair value at the date of transition as deemed cost; or • Use a revaluation carried out at a previous date as deemed cost, subject to certain conditions
Employee benefits	Deferral of the recognition of actuarial gains and losses using the corridor approach in IAS 19 may be applied prospectively; if elected, exemption must be applied to all benefit plans

Optional Exemptions (cont.)

Optional exemption	Choice
Cumulative translation differences	The cumulative translation adjustment may be set to zero; if elected, the exemption must be applied to all subsidiaries
Compound financial instruments	The two equity components of a compound financial instrument do not need to be identified if the liability component is not outstanding at the IAS 32/39 transition date

Optional Exemptions (cont.)

Optional exemption	Choice
Date of adoption for subsidiaries	A subsidiary that adopts IFRS later than its parent can elect to apply IFRS 1 or to use the carrying amounts of its assets and liabilities included in the consolidated financial statements, subject to eliminating any consolidation adjustments
Designation of financial assets and financial liabilities	A company may choose to classify a financial instrument as a financial asset or financial liability "at fair value through profit or loss" or as available for sale at its IAS 32/39 transition date

Optional Exemptions (cont.)

Optional exemption	Choice
Share-based payments	A company may choose to apply IFRS 2 to any equity instruments granted prior to Nov 7, 2002 or that vested before the date of transition to IFRS, but only if the company has previously disclosed publicly the fair value of the instruments, determined at the measurement date
Decommissioning liabilities included in the cost of PP&E	A company may choose to not comply with the requirements of IFRIC 1 for changes in decommissioning liabilities that occurred before the date of transition to IFRS

Optional Exemptions (cont.)

Optional exemption	Choice
Leases	A company may determine whether an arrangement existing at the date of transition to IFRS contains a lease on the basis of facts and circumstances existing at that date
Fair value measurement of financial instruments	A company may apply the requirements of IAS 39.AG76-AG76A in any of the following ways: • Retrospectively; • Prospectively to transactions entered into after October 25, 2002; or •Prospectively to transactions entered into after January 1, 2004

Mandatory Exceptions

Mandatory exception	Requirement
Estimates	Hindsight cannot be used to create or revise estimates; the estimates made under a company's previous GAAP are revised only to correct errors and for changes in accounting policies
Hedge accounting	Hedge accounting can be applied to transactions that satisfy the hedge accounting criteria in IAS 39 prospectively from the company's IAS 32/39 transition date; hedging relationships cannot be designated retrospectively, and the supporting documentation cannot be created retrospectively

Mandatory Exceptions (cont.)

Mandatory exception	Requirement
Derecognition of financial assets and liabilities	The IAS 39 derecognition requirements should be applied from January 1, 2004; assets and liabilities derecognized before this date should not be recognized in the first IFRS financial statements unless: • The company chooses to do so; and • The information necessary to apply the IAS 39 derecognition criteria was gathered when the transactions were initially accounted for

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Differences in Principle

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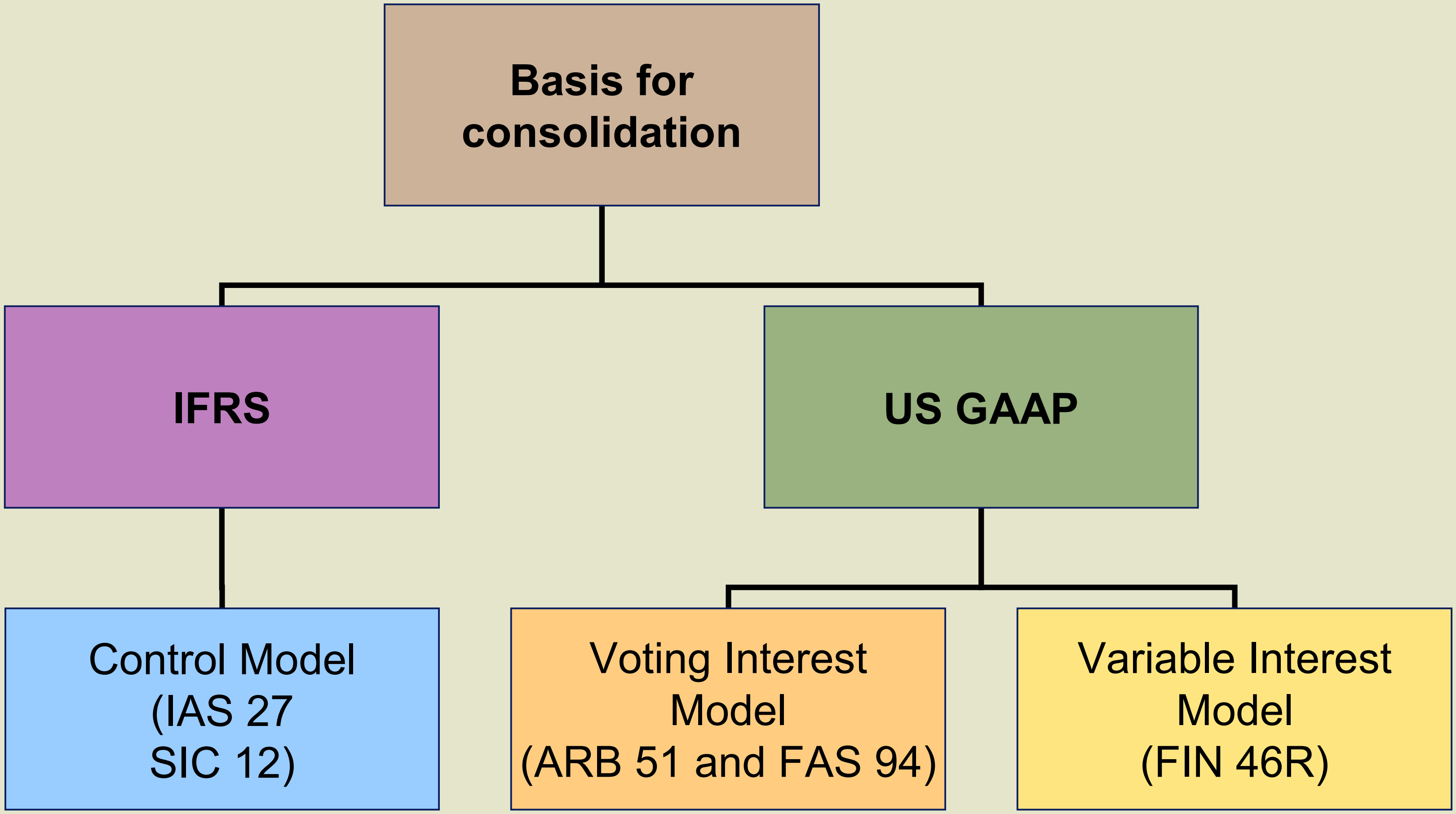
“Principle-based” Standards

- Articulate underlying objective
- Provide necessary guidance to make operational and consistent application
- Broad applicability (limit on scope exceptions)
- Limit arbitrary “bright lines” (percentage tests)
- Limit alternative treatments for similar transactions
- Simplify, simplify, simplify

Areas Where Different Principle

- **Consolidation policy**
- Hyperinflationary accounting
- **Impairment of assets**
- **Provisions and contingencies**
- Intangible assets
- **Business Combinations**

Overview of Consolidation Policy



Consolidation Policy

Area	IFRS	US GAAP
Primary literature	IAS 27 *Consolidated and Separate Financial Statements* SIC 12, *Consolidation – Special Purpose Entities*	ARB 51 SFAS 94 FIN 46R
Basis for consolidation	Based on "control"; look to governance and economics (risks and rewards) indicators	General approach based on majority voting interests; consolidate VIEs if primary beneficiary

“Control” Approach

- Power to govern the entity’s financial and operating policies so as to obtain benefit
  - Financial policies
  - Operating policies
- In determining control, must weigh governance and economic indicators
- Governance versus management

"Control" Approach, cont.

Governance Indicators	Economic Indicators
Voting rights	Dividends
Ability to appoint management	Guarantees
Ability to appoint Board of Directors	Rights to future benefits
Power to dissolve or change the entity	Rights to residual interests

Consolidation Policy, cont.

Area	IFRS	US GAAP
Different accounting policies	Must conform policies	No requirement to conform policies
Different reporting dates of parent and subsidiaries	Reporting dates need to be within three months; must adjust significant differences	Reporting dates need to be within three months; must disclose significant differences
Presentation of minority interest	Within equity	Outside of equity, between liabilities and equity
Potential voting rights	If currently exercisable consider in assessing control	Not considered until exercised

Impairment of assets

- Guidance

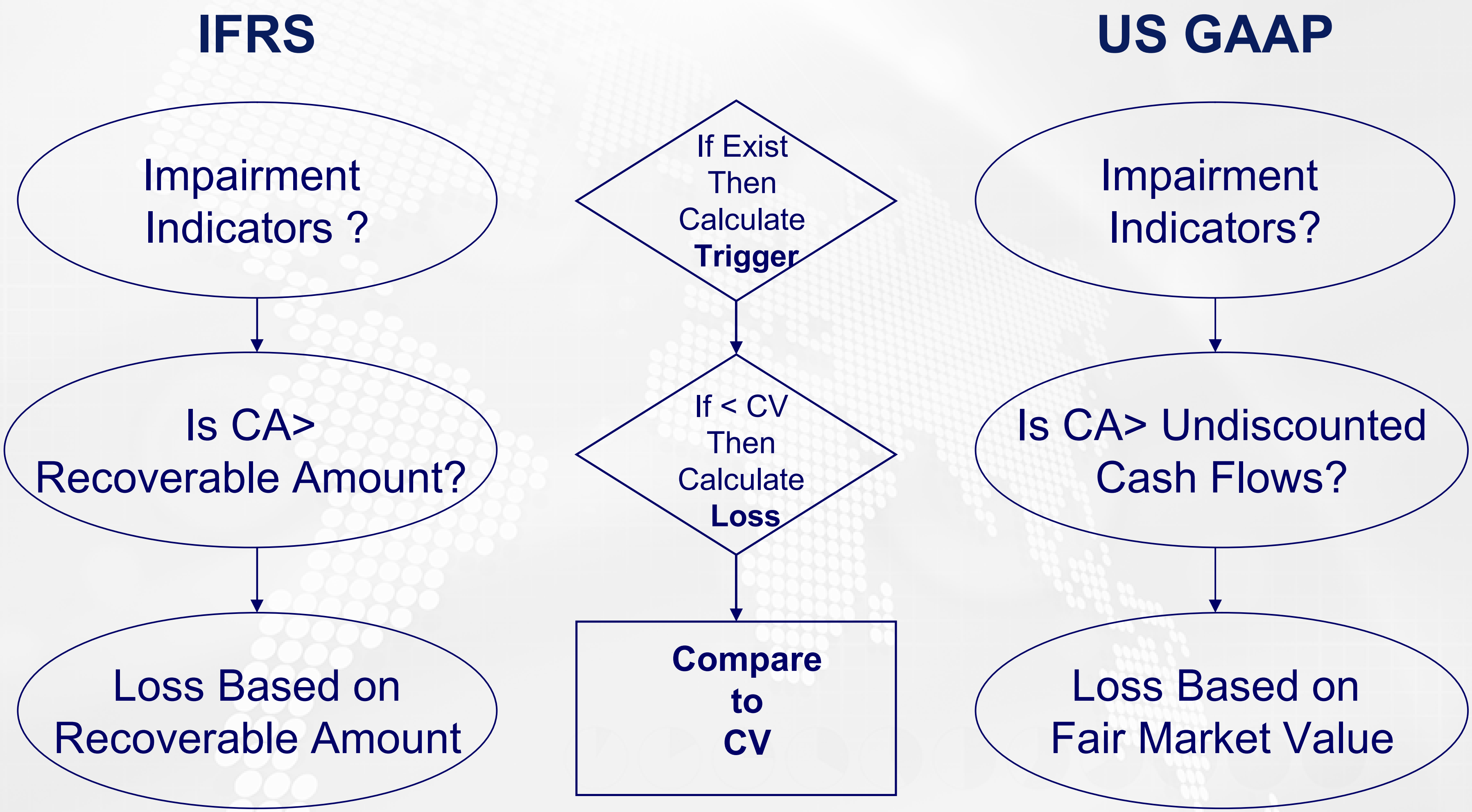
IFRS

– IAS 36 *Impairment of Assets*

US GAAP:

– SFAS 142, *Goodwill and other intangible assets*
– SFAS 144, *Impairment of Assets*

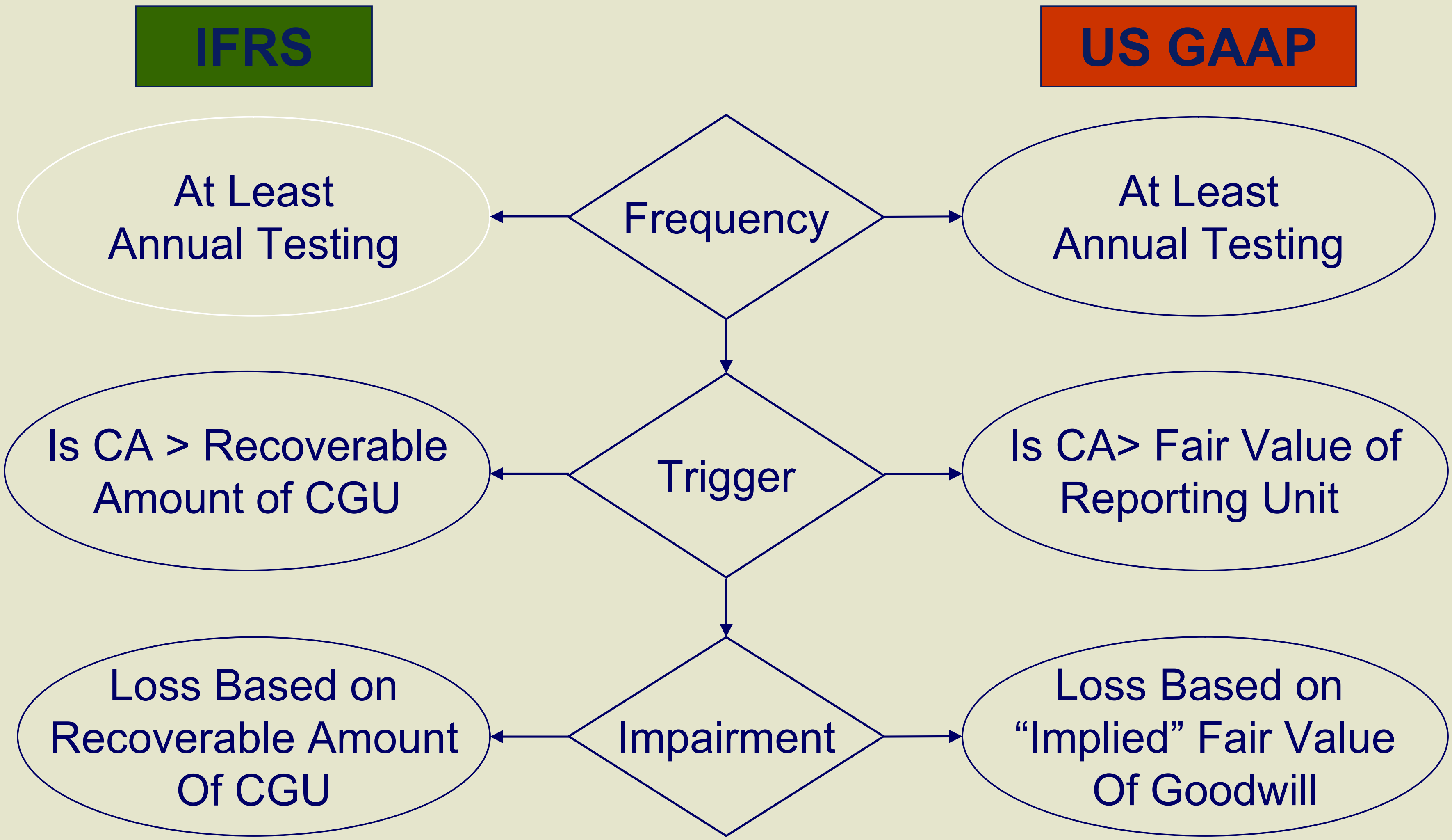
Impairment of assets (other than goodwill)



Impairment of assets - example

Asset carrying amount	100
Value in use	90
Fair value less costs to sell	80
Fair market value	85
Undiscounted cash flows	110
Impairment loss-IFRS	10
Impairment loss -US GAAP	0

Impairment of assets - goodwill



Impairment of goodwill - example

Asset	Carrying Amount	Fair value
Cash	150	150
Accounts Receivable	300	300
Equipment	350	350
Land	350	200
Goodwill	50	
Liabilities	200	200

Calculate the impairment loss

– Under IFRS if the recoverable amount is R900

– Under US GAAP if the FV of the reporting unit is R900

Impairment of goodwill - example

- Assumptions
  - Prior to performing this goodwill impairment test, no individual asset was triggered for impairment.
  - Under IFRS, any impairment loss in excess of goodwill is allocated on a pro-rata basis first to non-current assets and secondly to current assets. This allocation may not result in an asset being carried below its fair value.

Impairment of goodwill - IFRS

Asset	Carrying Amount-Old	Carrying Amount-New	
Cash	150	150	
Accounts Receivable	300	300	
Equipment	350	325	50
Land	350	325	
Goodwill	50	0	50
Liabilities	200	200	
Net Assets	1000		
Recoverable amount	900		
Impairment loss	100		

Impairment loss: 100

Impairment of goodwill – US GAAP

Asset	Carrying Amount-Old	Fair value
Cash	150	150
Accounts Receivable	300	300
Equipment	350	350
Land	350	200
Goodwill	50	
Liabilities	200	200
Net Assets	1000	800
Fair value of reporting unit	900	900
Difference so must calculate implied FV	100	
Implied FV of goodwill		100

Impairment loss: 0 (100>50)

Impairment of assets

- Subsequent reversal of impairment loss on assets other than goodwill
  - IFRS: Required provided certain criteria are met, prohibited for goodwill
  - US GAAP: Prohibited

- Impact of foreign currency adjustments on impairment test of subsidiary to be disposed of
  - IFRS: Foreign currency adjustments are excluded
  - US GAAP: Foreign currency adjustments are included

Provisions and Contingencies

Area	IFRS	US GAAP
Primary literature	IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*	SFAS 5 SFAS 143 SFAS 146
Recognition threshold	Based on “more likely than not” threshold	Based on “probable” threshold

Provisions and Contingencies, cont.

Area	IFRS	US GAAP
Measurement of liabilities	Best estimate to settle the obligation, generally the expected value	Best estimate, if a range of possible amounts, then at the low end
Measurement of decommissioning provisions	Must adjust the discount rate at each reporting date	Do not adjust the discount rate at each reporting date
Discounting of provision	Provision to be recorded at discounted value if discounting is material	Discounting only if the total amount and timing of payments are fixed or readily determinable

Intangible Assets

Area	IFRS	US GAAP
Primary literature	IAS 38 *Intangible Assets*	SFAS 2 SFAS 86 SFAS 142
Recognition of development costs	Capitalize internally generated intangibles if it meets certain criterion	Generally expense internally generated intangibles except for certain web site development costs and costs on internally generated software
Recognition of intangible assets on business combination	Some guidance on nature and recognition of intangibles	Detailed guidance on recognition and measurement of intangibles
Revaluation of intangible assets	Permitted only if an active market exists	Generally prohibited

Business Combinations

Area	IFRS	US GAAP
Primary literature	IFRS 3 *Business Combinations*	SFAS 141
Date on which consideration in a business combination is measured	**Acquisition date (date on which control passes)**	For share exchanges use date when terms are agreed; for cash consideration generally use consummation date
Purchased in-process research and development	**Capitalized as an acquired finite-life intangible**	Expensed

Business Combinations, cont.

Area	IFRS	US GAAP
Restructuring provisions	**Prohibited unless previously recognized by the acquiree**	Can be recognized if management has a plan by consummation date and carried out within a year
Date on which contingent consideration is recorded (as part of consideration)	**Acquisition date (if the amount is probable and can be measured reliably).**	Generally when contingency is resolved.

Business Combinations, cont.

Area	IFRS	US GAAP
Measurement of Minority Interest	**Minority's percent of fair value**	Minority's percent of carrying amount (book values) on acquired company's books
Negative Goodwill	**Recognize as a gain**	Initially allocate on a pro rata basis against the carrying amount of certain non-financial assets, with any excess recognized as an extraordinary gain

Substantially converged, but differences remain:

- **Definition of fair value**
- **References to other standards that have not converged**
- **Options with respect to fair value of minority interest**

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Choices

"Choices, choices, choices."

Choices

- Depending on choice may or may not have a US GAAP difference
- Once make a choice must consistently apply
- If subsequently change accounting policy, must be “more appropriate” under IAS 8
  - Similar to “preferability” under US GAAP
- Group accounting policies must be conformed
  - May have different policy in separate parent or subsidiary financial statements

Areas Involving "Choices"

Area	IFRS	US GAAP
Presentation	Expense by nature or by function	Expense by function
Inventories	FIFO or weighted average	FIFO, LIFO or weighted average
Property	Cost or fair value	Cost
Government grants	Gross or net	N/A

Areas Involving "Choices", cont.

Area	IFRS	US GAAP
Borrowing costs*	Expense or capitalize	Capitalize
Joint ventures	Equity method or proportionate consolidation	Equity method

***As a result of the convergence efforts, the IASB issued a revised IAS 23 *Borrowing Costs* to require capitalization of borrowing costs. Effective January 2009 (early adoption permitted)**

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Level of Detail

"The devil's in the details."

Differences in "Details"

- Degree of "implementation guidance"
- Application to specialized industries
- Must consider hierarchy in IAS 8
  - Consistency with Framework
  - Look to requirements of similar standards
  - Look to financial statement elements, recognition and measurement criteria in Framework
  - Most recent pronouncements of other standard-setters with similar framework
- In applying US GAAP pronouncements, must consider consistency with overall "principle"

Areas Where Differences in "Detail"

- Inventories
- Income taxes
- Property, plant and equipment
- Leases
- **Revenue recognition**
- Employee benefits
- Foreign currency
- Borrowing costs
- Financial instruments
- Share-based payment
- Business combinations
- Insurance contracts

Revenue Recognition

Area	IFRS	US GAAP
Primary literature	IAS 18 *Revenue* *SIC 31, I*	SAB 104 for public companies
Revenue recognition guidance	General principles are consistent with US GAAP but contain limited detailed or industry specific guidance	Much more specific guidance

General Principles

IAS 18 - Goods	US GAAP	IAS 18 - Services
Implicit	Evidence Of Arrangement	Implicit
Transfer of Risks & Rewards	Delivery	Percent of Completion
Reliable Measurement	Fixed or Determinable Price	Reliable Measurement
Reliable Measurement	Collectability	Reliable Measurement

Revenue Recognition

Area	IFRS	US GAAP
Construction type contracts	Prohibits use of completed contract method	Allows completed contract under certain circumstances
Customer Loyalty programs	Considered multiple element for which revenue should be deferred	Practice may vary between accrual approach and multiple element approach

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Areas Not Addressed by IFRS

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Areas Not Addressed by IFRS

- Specialized industry guidance
  - Insurance
  - Extractive industries (Oil & Gas, Mining)
  - Motion pictures
  - Broadcasting
  - Record and music
  - Not-for-profit

Areas Not Addressed by IFRS

- Specific topics
  - Development stage enterprises
  - Debt restructuring
  - Bankruptcy
  - Common control

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